

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking on the  
Commission's Own Motion to Assess and Revise  
the New Regulatory Framework for Pacific Bell  
and Verizon California Incorporated.

Rulemaking 01-09-001  
(Filed September 6, 2001)

Order Instituting Investigation on the  
Commission's Own Motion to Assess and Revise  
the New Regulatory Framework for Pacific Bell  
and Verizon California Incorporated.

Investigation 01-09-002  
(Filed September 6, 2001)

**ADMINISTRATIVE LAW JUDGE'S RULING REGARDING VERIZON'S  
MOTION TO STRIKE PORTIONS OF ORA'S PHASE 1 TESTIMONY**

This ruling grants in part and denies in part the motion filed by Verizon California Incorporated (Verizon) to strike portions of the Phase 1 opening testimony filed by the Office of Ratepayer Advocates (ORA).

**Background**

The scope of Phase 1 is set forth in (1) the Commission's combined Order Instituting Rulemaking 01-09-001 & Order Instituting Investigation 01-09-002 (Order), and (2) the Assigned Commissioner's Ruling Determining the Category, Scope, Schedule, Need for Hearing, and the Principal Hearing Officer for the Proceeding issued on December 27, 2001 (ACR). As set forth in both the Order and the ACR, parties may address in Phase 1 what corrective measures, if any, the Commission should implement at the conclusion of Phase 1 in response to

ORA's audit of Verizon. In particular, parties may propose ratemaking adjustments that are based on ORA's audit, but any party making such a recommendation has the burden of demonstrating that its proposal has a clear and direct connection to ORA's audit report, is legal, and is consistent with the New Regulatory Framework (NRF).<sup>1</sup> In Phase 3, parties will have an opportunity to recommend specific revisions to NRF based on ORA's audit. Accordingly, parties may not recommend revisions to NRF in Phase 1 unless the revisions are remedial actions taken in response to ORA's audit that should be implemented expeditiously.

The parties submitted Phase 1 opening testimony on January 22, 2002. In its testimony, ORA recommends, among other things, the following:

- Reduce Verizon's rates by a total of \$112 million over three years. The proposed rate reduction equals the amount of the alleged accounting errors and improprieties that ORA found during its audit of Verizon.<sup>2</sup>
- Make Verizon's rates subject to refund pending the conclusion of Phase 3.
- Require Verizon to track in a memorandum account the amount of its earnings that exceed the former sharing benchmark of 13%<sup>3</sup> (referred to hereafter as "sharable earnings").

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<sup>1</sup> ACR, p. 4.

<sup>2</sup> Verizon disputes many of ORA's audit findings. Today's ruling makes no determinations regarding the merits of ORA's audit findings.

<sup>3</sup> ORA recommended that Verizon should be required to track its earnings that exceed the "sharing benchmark of 12%." There was never a sharing benchmark of 12% for Verizon. Rather, the Commission established a sharing benchmark of 13% in D.89-10-031 (33 CPUC 2d 43, 233), and suspended sharing for Verizon in D.93-09-038 (50 CPUC 2d 684, 695). This ruling assumes that ORA meant to recommend that Verizon should be required to track its earnings in excess of the former sharing benchmark of 13%.

- Require Verizon to report its sharable earnings on a monthly basis.
- Reinstate the former sharing ceiling of 15.5%.

On February 22, 2002, Verizon filed a motion to strike those portions of the Opening Testimony of ORA's witness Danilo E. Sanchez that pertain to the previously identified recommendations. Verizon argues that ORA's proposal to reduce Verizon's rates by \$112 million should be stricken because ORA failed to demonstrate that its proposal has a clear and direct connection to its audit report, is legal, and is consistent with NRF. Verizon argues that ORA's other proposals should be stricken because they have no connection to ORA's audit report and address matters that are reserved for Phase 3. ORA opposes Verizon's motion to strike, while Pacific Bell supports the motion.

### **Discussion**

Verizon's motion to strike ORA's proposal to reduce Verizon's rates by \$112 million is denied. As set forth in the ACR, the criteria for determining whether ORA's proposed rate reduction is within the scope of Phase 1 are as follows: (1) the proposal must have a clear and direct connection to ORA's audit, (2) the proposal must be legal, and (3) the proposal must be consistent with NRF. It is premature to determine whether ORA's proposal satisfies these criteria. Rather, this determination should be made after the parties have had an opportunity to develop the record via evidentiary hearings and to present arguments in their post-hearing briefs that reflect the evidentiary record.<sup>4</sup>

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<sup>4</sup> ORA's proposed rate reduction and Verizon's motion to strike both hinge, in part, on their contradictory interpretations of the Commission Advisory and Compliance Division's Workshop III Report that was adopted by the Commission, with modifications, in D.91-01-056. (See the Opening Testimony of Danilo E. Sanchez, pp. 14-15, and Verizon's motion to strike, pp. 6-7). So far, neither party has provided a copy of the Report.

*Footnote continued on next page*

Verizon's motion to strike ORA's proposal to make Verizon's rates subject to refund is denied. Verizon argues that ORA's proposal is not related to ORA's audit and addresses matters that are reserved for Phase 3. It is premature to decide whether ORA's proposal is related to its audit. This is a factual issue that should be decided after the parties have had an opportunity to develop the record via evidentiary hearings and to present arguments in their post-hearing briefs that reflect the evidentiary record. If it is determined that ORA's proposal does relate to its audit, and ORA's assertion that the alleged accounting errors and improprieties that it found during its audit are harming ratepayers is found to be true, then ORA's proposal constitutes the type of remedial action that is properly within the scope of Phase 1.

Verizon's motion to strike ORA's proposal to require Verizon to track sharable earnings in a memorandum account is denied for the reasons set forth in the previous paragraph.<sup>5</sup> Furthermore, even though ORA's proposal involves the NRF sharing mechanism – a matter that is reserved for Phase 3 – the disposition of any sharable earnings is left to another time. Consequently, ORA's proposal does not affect the NRF sharing mechanism in Phase 1. Therefore,

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Presumably, one of the parties will submit a copy of the Report during the course of evidentiary hearings.

<sup>5</sup> The obvious purpose ORA's proposals to make Verizon's rates subject to refund and to require Verizon to track its sharable earnings in a memorandum account is to lay the groundwork for imposing ratemaking adjustments at a later time. Accordingly, as set forth on page 4 of the ACR, ORA has the burden of demonstrating that its proposals are legal and consistent with NRF. The determination of whether ORA's proposals meet these criteria should be made after the parties have had an opportunity to develop the record via evidentiary hearings and to present arguments in their post-hearing briefs that reflect the evidentiary record.

ORA's proposal is consistent with the Commission's determination in the Order that it will address issues associated with the sharing mechanism in Phase 3.

Verizon's motion to strike ORA's proposal to require Verizon to report its sharable earnings on a monthly basis is granted. As set forth in the Order,<sup>6</sup> issues pertaining to NRF monitoring reports will be addressed in Phase 3.<sup>7</sup> Verizon's motion to strike ORA's proposal to reinstate the sharing ceiling of 15.5% is also granted. As set forth in both the Order and the ACR,<sup>8</sup> issues regarding the NRF sharing mechanism will be addressed in Phase 3.<sup>9</sup>

### **Conclusion**

The following portions of the Opening Testimony of Danilo E. Sanchez are stricken:

- Last two sentences on page 22 (i.e., last two sentences of Answer 23).
- First full sentence at the top of page 25 (i.e., first full sentence of the fifth paragraph of Answer 24).

To avoid possible confusion, ORA shall provide all parties and the assigned Administrative Law Judge with a copy of its testimony that has been revised to reflect today's ruling no later than three business days from the effective date of this ruling.

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<sup>6</sup> Order, Appendix A, p. A-10.

<sup>7</sup> Although Verizon currently reports its sharable earnings via advice letters, the advice letters themselves constitute a NRF monitoring report. (D.98-10-026, Ordering Paragraph 1.c.)

<sup>8</sup> Order, Appendix A, p. A-6, and ACR, pp. 7-8.

<sup>9</sup> If the Commission adopts ORA's proposal in Phase 1 to make Verizon's rates subject to refund, ORA may address in Phase 3 whether the amount of any refund should be based, in whole or part, on the sharing ceiling.

Therefore, **IT IS RULED** that:

1. Verizon California Incorporated's (Verizon) motion to strike the Opening Testimony of Danilo E. Sanchez is granted and denied to the extent set forth in the body of this ruling.

2. Within three days from the effective date of this ruling, Office of Ratepayer Advocates (ORA) shall provide the assigned Administrative Law Judge with redacted and unredacted versions of the Opening Testimony of Danilo E. Sanchez that have been revised as set forth in the body of this ruling.

3. Within three days from the effective date of this ruling, ORA shall provide the parties with a redacted copy of the Opening Testimony of Danilo E. Sanchez that has been revised as set forth in the body of this ruling. ORA shall also provide a revised copy of the unredacted Opening Testimony of Danilo E. Sanchez to those parties that previously received an unredacted copy of the testimony.

Dated March 13, 2002, at San Francisco, California.

/s/ TIMOTHY KENNEY

Timothy Kenney  
Administrative Law Judge

**CERTIFICATE OF SERVICE**

I certify that I have by mail, and by electronic mail, to the parties to which an electronic mail address has been provided, this day served a true copy of the original attached Administrative Law Judge's Ruling Regarding Verizon's Motion to Strike Portions of ORA's Phase 1 Testimony on all parties of record in this proceeding or their attorneys of record.

Dated March 13, 2002, at San Francisco, California.

/s/ ERLINDA PULMANO

Erlinda Pulmano

**N O T I C E**

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